CIA/OER/S-06779-75 IMPACT OF WESTERN INFLATION FEB 75

CONF 01 OF 01

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MEMORANDUM FOR:

Attached is a copy of the report that U/EE sent to [redacted] on 13 February 1975.

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CIA/OER/S-06779-75

Impact of Western Inflation and Higher Oil Prices on Hungary

Purchases of high-priced Western crude oil, chemical products, sugar, and cotton resulted in a sharp decline in Hungary's terms of trade and a record foreign trade deficit with the West in 1974. During the first nine months of 1974, the price of Hungarian imports from the West rose 44.5% while export prices rose only 22.4%. Moreover, export volume to the West slumped slightly during the same period as the Western recession and EEC import ban on meat shrank export markets. Subsidies to offset import price increases rose from 2% of budget expenditures in 1973 to 9% in 1974.

The Hungarians have responded with a comprehensive package of remedies for 1975 including: (a) a cutback in growth plans especially for industrial production and real wages; (b) a redirection to the socialist countries for imports by tightening credit and restricting import licenses for imports from the West; (c) a boost in investment in the energy and food sectors; (d) increases in production goals for coal, natural gas, sugar beets, soybeans, and sunflower seeds; and (e) a strict energy conservation program.

The Hungarian economic reform -- the only genuine reform program in Eastern Europe -- will be further trimmed. Managerial freedom in planning production, foreign trade, and investment has been eroded since the overinvestment binge and $300 million trade deficit with the West in 1971.

Current problems of high world prices and an eleven-month deficit in 1974 of $660 million have led economic chief Karoly Nemeth to call for more direct control over the economy. A complete abandoning of the reform is unlikely -- producer prices for raw materials were raised substantially in January 1975 in order to reduce subsidies and restore the exposure of enterprises to world market forces.

Hungary's total consumption of crude oil in 1974 amounted to nine million tons. Two million tons were produced domestically, six million tons were imported from the Soviet Union and about one million tons were imported from the Middle East. Hungary's net imports of products were about 500,000 tons. The rise in world market oil prices caused the value of Hungarian crude oil imports from the West to increase to $95 million or about 6% of total imports from the West as compared with 2% in 1973. The bill for imports was partially offset by about $20 million in product exports to the West.

Domestic production in 1975 will remain stable and imports will rise to slightly more than 7 million tons. Oil imports from the West will equal about $110 million; product exports will again total about $20 million. By 1980, increased dependence on Western oil could raise the bill for Western oil to more than $500 million annually.

The major development in 1975 is the recent Soviet decision to raise crude oil prices to its CEMA trading

partners from under $3.00 to about $6.50 a barrel. The rise in oil prices will increase the Soviet oil bill to Hungary by $185 million this year -- an amount equal to 12% of total Hungarian exports to the Soviet Union in 1974.

And the Hungarians can look forward to even higher Soviet oil prices after 1975. According to Polish Premier Jaroszewicz, CEMA raw material and industrial prices will be adjusted each year on the basis of the average world price for the preceding five years. By 1980, the Soviet oil bill could reach $500 million annually.